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► **IRS is winning lawsuits that disqualify business purchases owned by traditional IRAs!**

Recent court cases show that the IRS is focused on challenging business purchases by taxpayers using their IRA accounts. A traditional IRA is a type of trust account that must comply with certain IRS requirements. As noted in Internal Revenue Code Section 408(a), there are prohibited transactions for qualified plans including IRAs.

Enclosed is background with these IRS legal challenges: A prohibited transaction is one that improperly uses funds of an IRA by the IRA owner or a disqualified person. A disqualified person includes a fiduciary and members of the IRA owner's family such as a spouse, ancestor, lineal descendant and any spouse of a lineal descendant. Here are a few examples of prohibited transactions with a traditional IRA.

- Borrowing money from the IRA.
- Selling property to it.
- Using it as security for a loan.
- Buying property for personal use (present or future) with IRA funds.

In recent court cases filed by the IRS, the service objected to Rollover Business Start-ups, ROBS. ROBS is an arrangement in which prospective businesses owners use their retirement funds to pay for new business start-up costs. While not yet considered abusive tax avoidance transactions, the service questions the transactions, because they may solely benefit one individual – the one who rolls over his or her existing retirement funds to the ROBS plan in a tax-free transaction. The plan then uses the rollover assets to purchase the stock of the new business.

1. The IRS is concerned that the ROBS plans allow the business buyer to access tax-deferred retirement funds without paying taxes upon the distribution of these funds.
2. Also, the IRS documented concerns that the taxpayers who establish ROBS may not understand that a qualified plan, IRA, is a separate entity with its own set of requirements. In a ROBS arrangement, the IRA, through its purchase of company stock investment, rather than the individual, owns the trade or business and must comply with requirements such as information reporting, coverage, and nondiscrimination, and could potentially violate benefits requirements.



In a 2013 court case [Ellis v. Commissioner, Tax Court Memo 2013-245] the Tax Court determined that the taxpayer entered into a prohibited transaction when his used car sales business, an LLC owned 98% by his IRA, paid him a salary as general manager of the business. This caused the termination of the IRA and deemed distribution on the first day of the tax year in an amount equal to the fair market value of the IRA.

The Eighth Circuit Court of Appeals agreed with the Tax Court's findings that both the taxpayer and the LLC were disqualified persons. It then noted that the only issue on appeal was whether the payment of wages by the car business to Mr. Ellis was a prohibited transaction. [Ellis v. Commissioner, 115 AFTR 2d 2015-2072, CA-8, 2015].

- a. The Court rejected the taxpayer argument that a prohibited transaction did not occur with regard to his salary being drawn from the LLC's corporate account and not the IRA account. The court stated the plain language of Sec 4975 (c) which prohibits both "direct and indirect" self-dealing of the income and assets of a qualified plan, an IRA.

These court cases as well as other recent cases are concerns for taxpayers to consider seriously. In addition, this case raises the question as to whether taxpayers should use IRA funds for privately-held business startups including business ventures with direct investments in real estate. Beware: The IRS could easily argue and win court cases disqualifying IRA accounts and ROBS that invest directly in real estate.

Regular Piece

How To Make The Most Of Your Newsletter

Be sure to read the article with the mindset 'How could this apply to our business.' Thinking of it that way will guarantee that you get value. Better yet, take notes as you read and commit to having the ideas implemented by the time the next edition arrives. Also, make copies for each team member. To really make sure something positive happens, work with your business development specialist to talk your team through the ideas and how to set a schedule for getting them implemented. We're here to help you get started.

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